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495958—42

In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 508

VIM SECURITIES CORPORATION, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 23–42) is reported in 43 B. T. A. 759. The opinion of the circuit court of appeals (R. 67–71) is reported in 130 F. (2d) 106.

JURISDICTION

The judgment of the circuit court of appeals was entered on August 6, 1942 (R. 72). The petition for a writ of certiorari was filed on November

2, 1942. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

(1) Whether gain realized by petitioner upon receipt of an award for the condemnation of its property is subject to the nonrecognition provisions of Section 112 (f) of the Revenue Act of 1936.

(2) Whether petitioner carried the burden of proving that it was not engaged in business within the meaning of the tax on excess profits.

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1935, c. 829, 49 Stat. 1014:

> SEC. 105. CAPITAL STOCK TAX.
>
> (a) For each year ending June 30, beginning with the year ending June 30, 1936, there is hereby imposed upon every domestic corporation with respect to carrying on or doing business for any part of such year an excise tax * * *.
>
> * * * * *
>
> SEC. 106. EXCESS-PROFITS TAX.
>
> (a) There is hereby imposed upon the net income of every corporation for each income-tax taxable year ending after the close of the first year in respect of which it is taxable under section 105, an excess-profits tax equal to the sum of the following:
>
> * * * * *

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section

* * * * *

(f) *Involuntary Conversions.*—If property (as a result of its destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation, or the threat or imminence thereof) is compulsorily or involuntarily converted into property similar or related in service or use to the property so converted, or into money which is forthwith in good faith, under regulations prescribed by the Commissioner with the approval of the Secretary, expended in the acquisition of other property similar or related in service or use to the property so converted, or in the acquisition of control of a corporation owning such other property, or in the establishment of a replacement fund, no gain or loss shall be recognized. If any part of the money is not so expended, the gain, if any, shall be recognized, but in an amount not in excess of the money which is not so expended.

* * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 112 (f)–1. *Reinvestment of proceeds of involuntary conversion.*—In order to

avail himself of the benefits of section 112 (f) it is not sufficient for the taxpayer to show that subsequent to the receipt of money from a condemnation award he purchased other property similar or related in use. The taxpayer must trace the proceeds of the award into the payments for the property so purchased. It is not necessary that the proceeds be earmarked, but the taxpayer must be able to prove that the same were actually reinvested in such other property similar or related in use to the property converted. The benefits of section 112 (f) can not be extended to a taxpayer who does not purchase other property similar or related in service or use, notwithstanding the fact that there was no other such property available for purchase.

* * * * *

STATEMENT

The facts, as found by the Board of Tax Appeals may be summarized as follows:

Petitioner Vim Securities Corporation is a corporation organized under the laws of the State of New York. It owned a parcel of real estate located at 16 Concord Street, Brooklyn, New York, which was condemned by the City of New York. The order of condemnation was entered by the Supreme Court of the State of New York on June 28, 1935, and the city took title to the property as of that date. By decree dated July 14, 1936, petitioner was awarded $90,312.50 for the condemned prop-

erty, subject to a $12,000 mortgage. When paid on October 9, 1936, the award amounted with interest to $91,604.09, of which $12,000 was used to satisfy the mortgage and $79,604.09 was received by petitioner. (R. 29–30.)

Prior to and at the time of the condemnation, the property was occupied by the Vim Electric Company as petitioner's tenant. From June 28, 1935, until the latter part of December of that year, the Vim Electric Company continued to occupy the premises under a temporary arrangement with the City of New York In the latter part of December 1935, the Vim Electric Company moved to 325–327 Gold Street, Brooklyn, New York, and it has since occupied those premises as a tenant, paying rent to the 325–327 Gold Street Corporation, Inc. (hereafter called the Gold Street Corporation). (R. 30.)

The Gold Street Corporation was organized under the laws of New York on October 1, 1935, with an authorized capital stock of $10,000 divided into 100 shares of $100 par value each. The original incorporators were Morris Borden, Anna Vinarsky, and Hyman Kaplan, each subscribing for one share of stock. Immediately after the incorporation, the original incorporators signed waivers and assigned their subscription rights, respectively, to Samuel Kassover, Julius Kassover, and Max Kassover, who, according to the minutes of the corporation, appear to have been the only

stockholders thereof. The stock certificate book of the corporation contains all certificates still in blank and indicates that no certificates of stock were ever issued from it. The record fails to show that any certificates of stock of the corporation were ever issued to anyone. The tax returns of the corporation for the calendar years 1935 and 1936 refer to Samuel, Max, Nathan, and Julius Kassover as each owning 12½ shares of the stock of the corporation. The stock of petitioner and the Vim Electric Company was owned in equal proportions by the four Kassover brothers, and Samuel was the president of both those corporations as well as of the Gold Street Corporation. (R. 31–32.)

On August 19, 1935, Julius Kassover entered into a contract with the Dime Savings Bank of Brooklyn, New York, to purchase the Gold Street property for $110,000—$10,000 to be paid upon the signing of the contract and the balance to be paid upon delivery of the deed, which was fixed for October 1, 1935. On October 4, 1935, the contract for the purchase of the Gold Street property was assigned to the Gold Street Corporation and on the same day the Dime Savings Bank deeded the property to the Gold Street Corporation. The deed was recorded on October 7, 1935, at the Register's Office, Kings County, New York. (R. 30–31.) The payments for the Gold Street property were made in the following manner: $2,000 was paid by

petitioner's check bearing date of August 13, 1935; the balance of the $10,000 deposit was paid by check of the Vim Electric Company dated August 19, 1935 (R. 32). On October 5, 1935,[1] three checks of the Vim Electric Company were drawn on the National City Bank of New York, one payable to the order of Julius Kassover, another payable to the order of Max Kassover, and the third payable to the order of Samuel Kassover, the first two being for $25,000 each and the third being for $50,000. The check for $50,000 was drawn for that amount because one of the four Kassover brothers was out of town. These three checks were endorsed to J. Kassover, who thereupon drew his individual certified check on the National City Bank of New York for $100,000, payable to the order of the Dime Savings Bank of Brooklyn, New York. This check was accepted in full payment of the balance due on the Gold Street property. On November 27, 1935, petitioner paid by check $8,000 to the Vim Electric Company as a refund for the $8,000 which it had paid the Dime Savings Bank by its check of August 19, 1935. (R. 33.)

The Board has made specific findings with respect to the manner in which the transaction was

[1] On the previous day the vendor bank had refused a tender of a certified check for $100,000 drawn by the Vim Electric Company because it did not wish to transfer title to the property to another corporation (the Gold Street Corporation) when the amount was being paid by the Vim Electric Company. This check was redeposited to the credit of the Vim Electric Company. (R. 32–33.)

treated upon the books of the three corporations (R. 34–37). For present purposes these findings may be summarized as follows: the Gold Street Corporation was treated as owning the new property and as being indebted to the Vim Electric Company for the full purchase price; interest at the rate of 5% was charged upon this indebtedness; the initial payment of $10,000 was treated as a debt owed petitioner by the Vim Electric Company.

The Gold Street Corporation filed separate income tax returns, kept separate books of account and had its own separate bank account (R. 31). In addition to the entries recording the acquisition of the Gold Street property and the indebtedness due thereon, the books of the Gold Street Corporation showed items entered under "Profit and Loss—Real Estate Taxes, Insurance, Interest on Mtges., Taxes, Depreciation." The tax returns of the Gold Street Corporation were made up from the book in which the foregoing entries appear. (R. 35.)

The admitted purpose of the organization of the Gold Street Corporation was to acquire the Gold Street property. This was done in order to conceal from the City of New York that there was being acquired another more valuable property for less money than the amount asked for the old property. (R. 31, 34, 39.)

As has been stated, petitioner received the condemnation award on October 9, 1936. It thereafter issued its checks to the Vim Electric Company as follows (R. 34–35):

Jan. 29, 1937	$20,000	May 20, 1937	$5,000
Jan. 30, 1937	10,000	June 4, 1937	10,000
Mar. 12, 1937	20,000	June 19, 1937	10,000
Apr. 29, 1937	5,000		
May 6, 1937	5,000	Total	$85,000

During the above period there were with negligible exceptions no other financial transactions between the two companies (R. 35).

The petition for redetermination filed with the Board contained no assignment of error with reference to excess profits taxes. Petitioner asserted that its "business in 1935 and 1936 was the ownership of realty and the leasing thereof to the Vim Electric Co., Inc." (R. 26.) The Commissioner's answer admitted that petitioner's business in 1936 was the ownership of realty but denied the other allegation. No reply was filed. (R. 26–27.)

In stating his case at the hearing before the Board, petitioner's counsel remarked that the question whether the corporation was doing business so as to be subject to excess profits tax "is not in the petition." On the ground that this point was not in issue, the Board sustained the Commissioner's objection to a question as to whether "petitioner did anything else for the next year after losing its building." Petitioner's income tax and excess profits tax returns state that its

business was "Owners and Operators — Real Estate", and the same answer is given in the capital stock tax return to the question, "Nature of business in detail." The income tax and excess profits tax return further states "Real estate, realty holding, real estate agents" as its "Nature of Business." Petitioner took deductions on its income tax return of $2,050.39 for attorney's fees and $25 for professional fees. (R. 27.) After the hearing it filed a motion to amend its petition to conform to the proof and brought into issue the question whether it was doing business so as to be subject to excess profits tax. This motion was granted. (R. 2, 24.)

The amount of the condemnation award exceeded petitioner's basis for the property. The Commissioner determined that the difference was taxable income in 1936 and accordingly assessed deficiencies in income and excess profits taxes. (R. 9–11.) The Board of Tax Appeals sustained the Commissioner's determination (R. 42). The circuit court of appeals affirmed (R. 72).

ARGUMENT

1. Petitioner lost its property as a result of the condemnation, but it did not "forthwith in good faith" expend the proceeds of the award "in the acquisition of other property * * * or in the acquisition of control of a corporation owning such other property," as required by Section 112

(f) of the Revenue Act of 1936. Indeed, so far as the record shows, it never acquired any other property to replace that which had been condemned.[2] It is true that the Gold Street Corporation did acquire similar property, but the Gold Street Corporation was a distinctly separate entity and may not be ignored at petitioner's behest. On this point the court below has followed the plain and unambiguous rule stated in *Higgins* v. *Smith,* 308 U. S. 473, 477, as follows:

> * * * A taxpayer is free to adopt such organization for his affairs as he may choose and having elected to do some business as a corporation, he must accept the tax disadvantages.

The rule of that case has been widely applied. See, *e. g., Commissioner* v. *Moline Properties* (C. C. A. 5th), decided November 7, 1942 (1942 Prentice-Hall, par. 63,018), reversing 45 B. T. A.

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[2] It is clear that petitioner never acquired control of the Gold Street Corporation. It did not acquire a single share of the stock of either the Vim Electric Company or the Gold Street Corporation. It failed even to satisfy the trier of fact that the stockholders of the Gold Street Corporation were the same as its own and those of the Vim Electric Company. (R. 40.) Article 45–1 of Treasury Regulations 94 (Pet. 10–11) lends no support to petitioner. That regulation is interpretive of a section of the statute which gives the Commissioner authority to make his own allocation of income among organizations controlled by the same interests in order to prevent the evasion of taxes. Those provisions obviously have no relation to any question here involved.

647; *Interstate Transit Lines* v. *Commissioner,* 130 F. (2d) 136 (C. C. A. 8th); *Texas-Empire Pipe Line Co.* v. *Commissioner,* 127 F. (2d) 220 (C. C. A. 10th); *Watson* v. *Commissioner,* 124 F. (2d) 437 (C. C. A. 2d).

If there are situations in which the rule of *Higgins* v. *Smith* does not apply, the instant case is certainly not one of them. The Gold Street Corporation was organized for the specific purpose of acquiring title to the new property, so that there could be concealed from the city the fact that a more valuable parcel of property was being acquired for less than the amount which was being claimed in the condemnation proceedings (see Statement, *supra,* p. 8). Not only was that purpose achieved, but it was apparently deemed desirable to continue the Gold Street Corporation after the condemnation proceedings had been completely terminated. There can be no unfairness therefore in treating the corporation as an existing, distinct entity. Moreover, the separate state of the corporate entities was scrupulously observed by the parties throughout all the transactions among the three corporations, and even more significantly, this was recognized in the income tax returns filed for the three corporations. Rent paid by the Vim Electric Company to the Gold Street Corporation was not reflected in the income of petitioner Vim Securities Corporation. The interest

charged to the Gold Street Corporation in 1937 was credited to the Vim Electric Company and not to petitioner. (See R. 35–36.) The Vim Securities Corporation has therefore insisted upon the separate identity of each corporation for all purposes including those of the federal income tax, with the exception of its contention in this case. These factors sharply distinguish the instant case from *United States* v. *Brager Building & Land Corp.*, 124 F. (2d) 349 (C. C. A. 4th), and *North Jersey Title Ins. Co.* v. *Commissioner*, 84 F. (2d) 898 (C. C. A. 3d).[3] It is true that in both those cases the corporate entity was disregarded at the behest of the taxpayer, but in each of them the taxpayer sought to have the corporation disregarded for *all* purposes of the federal income tax. Moreover, the *North Jersey Title Ins. Co.* case was decided prior to *Higgins* v. *Smith*, and the *Brager* case would probably not be followed in the Fourth Circuit since the reversal of its decision in *Powell* v. *Gray*, 114 F. (2d) 752 (C. C. A. 4th), in which this Court stated (314 U. S. 402, 414): "The choice of disregarding a deliberately chosen arrangement for conducting business affairs does not lie with the

[3] The court's disregard of the corporate entity in *Munson S. S. Line* v. *Commissioner*, 77 (F.) 2d 849 (C. C. A. 2d), was based upon the construction of the language and purpose of a special statute enacted to encourage the development of an American merchant marine.

creator of the plan. *Higgins* v. *Smith,* 308 U. S. 473, 477."

Even if it should be thought that there is still some question concerning the applicability of the rule of *Higgins* v. *Smith,* this case does not present a proper vehicle for determination of the question. For, as both the court below and the Board of Tax Appeals have held, the result reached is sustainable upon wholly independent and unimpeachable grounds. The regulations specifically authorized by Section 112 (f) provide that a taxpayer who seeks to come within that section must trace the proceeds of the award into the payments for the new property and must be able to prove that the proceeds were actually invested in it. In the instant case, payment for the new property was completed on October 5, 1935, and the award was not received until more than a year later, October 9, 1936 (see Statement, *supra,* pp. 5, 7). Manifestly, the proceeds of the award could not have been used to acquire the new property and Section 112 (f) is therefore inapplicable. *Bandes* v. *Commissioner,* 69 F. (2d) 812 (C. C. A. 2d). Moreover, those proceeds were not even distributed to the Vim Electric Company (which had advanced the purchase price of the new property) at the time of their receipt by petitioner. The first payment by petitioner to the Vim Electric Company was not made until almost four months after the receipt of the award, and the payments were

extended over a period of approximately five months. No explanation was offered for this delay (R. 39) and, as the court below pointed out (R. 71), "In the meantime, so far as appears, it retained the proceeds of the award and may for all that we can know have used them for general business purposes."

2. No question concerning the construction of the excess profits tax imposed by Section 106 (a) of the Revenue Act of 1935 is presented by this case. The opinions below do not decide that a corporation which neither owns nor operates property is carrying on or doing business within the meaning of that tax. The Board held that petitioner failed to prove that it neither owned nor operated property (R. 27–28). Furthermore, the record discloses that no issue was made in the pleadings before the Board upon this question; and the Commissioner's determination that petitioner was doing business was presumptively correct. *Welch* v. *Helvering,* 290 U. S. 111, 115. The decision of the circuit court of appeals is merely that the Board did not commit error in sustaining an objection to a question upon this point asked at the hearing, since it was not in issue in the case (R. 71).

CONCLUSION

The decision below is correct. There is no conflict upon either of the issues involved, and there

is therefore no occasion for further review. The petition should be denied.

Respectfully submitted.

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NOVEMBER 1942.

U. S. GOVERNMENT PRINTING OFFICE : 1942